

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 97-0506
Sales and Use Tax
For Years 1993 - 1995

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ISSUES

I. Sales/Use Tax Exemption: Equipment Used in Mine Reclamation.

Authority: Ind. Code § 6-2.5-3-2;
Ind. Code § 6-2.5-5-3;
Ind. Admin. Code tit. 45, r. 2.2-4-26;
Ind. Admin. Code tit. 45, r. 2.2-5-9;
Ind. Admin. Code tit. 45, r. 2.2-5-12;
Mechanics Laundry & Supply, Inc. v. Indiana Department of State Revenue, 650 N.E.2d 1223 (Tax Ct. 1995).

The taxpayer protests the imposition of use tax on equipment, repair parts, and consumables used to perform reclamation work at a coal mine site.

II. Sales/Use Tax Exemption: Equipment Used for Environmental Quality Compliance.

Authority: Ind. Code § 6-2.5-5-30;
Ind. Admin. Code tit. 45, r. 2.2-5-70.

The taxpayer protests the imposition of use tax on equipment, repair parts, and consumables used to comply with environmental quality standards.

III. Tax Administration: Penalty.

Authority: Ind. Code § 6-8.1-10-2.1;
Ind. Admin. Code tit. 45, r. 15-11-2.

The taxpayer protests the imposition of the ten percent (10%) negligence penalty.

STATEMENT OF FACTS

The taxpayer, an Indiana company, is a contract coal mining company and also performs construction and excavation work in Indiana and Kentucky. The issue in this tax protest concerns mine reclamation work performed by the taxpayer under contract with the Indiana Department of Natural Resources. The work performed by the taxpayer consisted of grading, backfilling, and salvaging topsoil at a surface coal mine site in southern Indiana. The site had been mined by another company, and subsequently abandoned, several years before the taxpayer performed the reclamation work. A sales and use tax audit for the period 1993-1995 was completed on April 18, 1997. The taxpayer was assessed use tax on its purchases of equipment, related repair parts, and consumable items used in the reclamation project. A ten percent (10%) negligence penalty was also assessed.

I. Sales/Use Tax Exemption: Equipment Used in Mine Reclamation.

DISCUSSION

The taxpayer argues that its purchases of equipment, related repair parts, and consumable items used in a mine reclamation project are exempt from use tax. The taxpayer cites Ind. Code § 6-2.5-5-3(b) as support for its position. That section of the code provides: “Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.” The taxpayer maintains that the reclamation work it did is part of the mining process and thus the taxpayer’s purchases are exempt from use tax. The taxpayer relies on an example from an Administrative Code regulation for its position that “refilling and grading of the mined area with overburden and waste material” is part of the mining process. Ind. Admin. Code tit. 45, r. 2.2-5-9(c)(example 2).

“An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana, if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.” Ind. Code § 6-2.5-3-2(a). The property at issue in this tax protest was stored, used, and/or consumed in Indiana and was acquired by the taxpayer in a retail transaction. The taxpayer’s purchases are subject to use tax unless those purchases qualify for an exemption.

Ind. Code § 6-2.5-5-3(b), quoted above, allows an exemption for certain property directly used in the direct mining of other tangible personal property. The equipment exemption, as that code section is known, was intended by the Legislature to be available to those engaged in the production of goods or other tangible property personal property only. Mechanics Laundry & Supply, Inc. v. Indiana Dept. of State Revenue, 650 N.E.2d 1223, 1230 (Tax Ct. 1995). The taxpayer, in this case, is producing no goods or tangible personal property by performing reclamation work.

The taxpayer is correct that “refilling and grading of the mined area with overburden and waste material” is part of the mining process but the reclamation work by itself does not constitute an activity that permits application of the equipment exemption. Looking at the full text of the example cited by the taxpayer, it can be seen that what is being described is an integrated process, not an isolated activity:

Coal is produced in a surface mining operation that begins with the clearing of surface obstacles and overburden from the land above the coal deposit to be mined, continues with the removal of waste material and with the extraction of the coal, continues further with the transportation from the coal seam to the processing facility, continues further with the refilling and grading of the mined area with overburden and waste material from a subsequently mined area, continues further with the cleaning of the coal, and ends with the stockpiling of the coal to allow moisture to drain and evaporate from the washed coal, thereby reducing moisture levels to a standard more generally acceptable to coal purchasers. Because of the functional interrelationship of the various steps and the flow of the work-in-process, the total process comprised of such activities is integrated.

Ind. Admin. Code tit. 45, r. 2.2-5-9(c)(example 2).

Reclamation of a mine site, independent of the mining operation itself, is not an activity that qualifies the taxpayer for a use tax exemption.

The taxpayer cites Ind. Admin. Code tit. 45, r. 2.2-5-9(h) for its position that replacement parts it purchased are exempt from use tax. “Replacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment . . . are exempt from tax.” Ind. Admin. Code tit. 45, r. 2.2-5-9(h)(2). The equipment the replacement parts are for is not exempt, therefore, the purchases of the replacement parts are subject to use tax.

The taxpayer cites Ind. Admin. Code tit. 45, r. 2.2-5-12(c) for its position that property consumed by its equipment in the reclamation work should be exempt from use tax.

The state gross retail tax does not apply to purchases of materials to be directly consumed in the production process or in mining, provided that such materials are directly used in the production process; i.e., they have an immediate effect on the article being produced. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

Ind. Admin. Code tit. 45, r. 2.2-5-12(c).

The taxpayer is not engaged in mining or any production process when performing reclamation work, and no tangible personal property is being produced. Therefore, the property being consumed

by the taxpayer's equipment is subject to use tax. The taxpayer is a contractor, as stated in its protest letter. The taxpayer was under contract with the Indiana Department of Natural Resources to perform a mine reclamation project, an improvement to real estate. "Utilities, machinery, tools, forms, supplies, equipment or any other items used by or consumed by the contractor and which do not become a part of the improvement to real estate are not exempt regardless of the exempt status of the person for whom the contract is performed." Ind. Admin. Code tit. 45, r. 2.2-4-26(e). The equipment, repair parts, and consumable items purchased by the taxpayer did not become part of the improvement to real estate and, thus, are subject to use tax.

FINDING

The taxpayer's protest is denied.

II. Sales/Use Tax Exemption: Equipment Used for Environmental Quality Compliance.

DISCUSSION

The taxpayer argues that the equipment, repair parts, and consumables it purchased for the reclamation project are tax exempt as environmental control equipment. The taxpayer cites Ind. Code § 6-2.5-5-30 and Ind. Admin. Code tit. 45, r. 2.2-5-70 to support its position. The environmental quality compliance statute reads in relevant part:

Sales of tangible personal property are exempt from the state gross retail tax if:

- (1) the property constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominantly used and acquired for the purpose of complying with any state, local, or federal environmental quality statutes, regulations, or standards; and
- (2) the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.

Ind. Code § 6-2.5-5-30.

The Administrative Code regulation is essentially identical to the statute. It is unknown from the evidence submitted whether the equipment purchased by the taxpayer was predominantly used to comply with environmental quality statutes. The taxpayer's representative did state during the hearing that the equipment was purchased prior to the performance of the reclamation work in question and that it was purchased for use in mining operations. It is evident then that the equipment was not acquired for the purpose of complying with environmental quality statutes, as is required to qualify for the tax exemption. Additionally, as has already been shown, the taxpayer was not engaged in the business of mining while performing the reclamation work that is the subject of this protest. The taxpayer's purchases of equipment, repair parts, and consumables are not exempt under the environmental quality compliance statute and are thus subject to use tax.

FINDING

The taxpayer's protest is denied.

III. Tax Administration: Penalty.

DISCUSSION

The taxpayer protests the imposition of a ten percent (10%) negligence penalty for its failure to remit use tax. If a taxpayer incurs a tax deficiency that, upon examination by the Department, is due to negligence, a ten percent (10%) penalty is imposed. Ind. Code § 6-8.1-10-2.1(a & b).

Negligence on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

Ind. Admin. Code tit. 45, r. 15-11-2(b).

The negligence penalty shall be waived if the taxpayer can show that the failure to remit the tax owed was due to reasonable cause and not due to willful neglect. Ind. Code § 6-8.1-10-2.1(d). The taxpayer maintains that it was not negligent, that it has instituted a use tax accrual system, and that the law regarding the taxability of reclamation work is ambiguous. The taxpayer has shown that its failure to remit use tax was due to reasonable cause, not willful neglect. The negligence penalty, therefore, is waived in this case.

FINDING

The taxpayer's protest is sustained.